

**Office of Chief Counsel
Internal Revenue Service**

memorandum

CC:SB:7:SEA:2:GL-114382-01
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date:

to: Lou Panelli, Special Procedures Function, PNW
M/S W-244

from: Associate Area Counsel, M/S W-670
(SBSE)

subject: **Estate Tax Lien Under Internal Revenue Code § 2057(i) (3) (P)**

You have requested our opinion on the proper filing of the Special Lien for Additional Estate Tax Attributable to Farm or Business Property Valuation pursuant to Internal Revenue Code § 2057(i) (3) (P). Your particular concern is ensuring that the lien attaches to qualified family-owned business property.

ISSUE

How should Service prepare and file the Special Lien for Additional Estate Tax Attributable to Farm or Business Property Valuation to ensure that it is perfected against the qualified family-owned business interest under Internal Revenue Code § 2057.

DISCUSSION

Internal Revenue Code § 2057¹ enacted in 1998 replaced Internal Revenue Code § 2033A, Family-owned Business Exclusion, and made certain changes to that statute. Section 2057 allows a qualified estate to take a deduction on its federal estate tax return to the extent of the qualified family owned business interest (QFOBI). The deduction is limited to \$675,000.00 Internal Revenue Code § 2057(a) (2). To qualify for the deduction the aggregate value of the decedent's qualified family-owned business interest passed to qualified heirs must exceed 50 percent of the decedent's adjusted gross estate. Internal

¹ Section 2057 provides for special estate tax relief for family-owned business interests similar to that provided by Internal Revenue Code § 2032A for certain farm and business real property.

Revenue Code § 2057(a)(1). QFOBI means an interest as a proprietor in a trade or business carried on as a proprietorship or an interest in an entity carrying on a trade of business if certain ownership requirements are met. Internal Revenue Code § 2057(e)(1). Specific ownership rules set forth in section 2057(e)(1)(B) limit entitlement to the deduction. The interest will not qualify if the business or related entity's stock or securities were publically traded at any time within three years of the decedent's death. Internal Revenue Code § 2057(e)(2)(B). The qualified interest also does not include any portion of the interest attributable to marketable securities in excess of day-to-day working capital needs of the business. Internal Revenue Service 2057(e)(2)(D).

The business can be operated in any form. Internal Revenue Code § 2057(e)(1).

The executor elects application of section 2057 by filing a written agreement. Internal Revenue Code § 2057(b)(1)(B). Each person who has an interest in the property designated by an agreement consenting to the application of the recapture of the tax attributable to the deduction must sign the agreement. Internal Revenue Code § 2057(h). If certain events occur within 10 years of decedent's death, an additional tax is imposed computed by reference to the reduction in estate tax attributable the heir's interest, or a percentage thereof, plus interest is recaptured. Internal Revenue Code § 2057(f). Each qualified heir is personally liable to the extent of the portion of the additional tax that is imposed with respect to his or her interest in the qualified family-owned business.

The only reference in section 2057 to the lien which will secure the tax attributable to the QFOBI is the listing of section 6324B (relating to special liens for additional estate tax) in section 2057(i), Other Definitions and Applicable Rules. Internal Revenue Code § 257(i)(3)(P).

Section 6324B provides for a federal estate tax lien to attach to qualified real property as defined by Internal Revenue Code § 2032A(b) in an amount equal to the tax attributable to the special farm valuation under Internal Revenue Code § 2032A. Internal Revenue Code § 6324B(a). The lien under section 6324A arises at the time the election under section 2032A is made. Internal Revenue Code § 6324B(c)(1) renders certain provisions of Internal Revenue Code § 6324A applicable to the 6324B lien. Specifically, the requirement that the lien be filed in accordance with 6323(f) in order for the lien to be valid as against any purchaser, holder of a security interest, mechanic's lien or judgment lien creditor. Internal Revenue Code §

6324A(d)(1). Further, the filed 6324B lien will not be valid against certain creditors entitled to a superpriority, i.e. real property tax liens, real property mechanic's liens for improvements, and real property construction financing agreements. Internal Revenue Code § 6324A(d)(3). Finally, the 6324B lien is in lieu of the regular estate tax lien arising under Internal Revenue Code § 6324.

Your question is how to perfect the estate tax lien against the QFOBI. Section 6324B was designed to provide for a lien against real property and it so provides for a lien on "qualified real property." In the case of the election under section 2057 you are dealing with a different type of asset which will secure the recapture tax which is the obligation of the heirs in the event it becomes due. The 2057(i)(3)(P) lien attaches to the heirs' interests in the qualified family-owned business.

Form 668H is filed to perfect the Service's lien against the interest in specially valued property under section 2032A. The same form of lien is contemplated for perfecting the lien against the family owned business interest held by the heirs making the election under section 2057. We assume that by reason of the reference to 6324B in the "other applicable provisions" subsection of 2057, i.e. 2057(i)(3)(P), the term "qualified family-owned business interest" should be substituted for "qualified real property" in reading section 6324B.

The Internal Revenue Manual references Form 668H as the proper 2057(i)(3)(P) lien to file once the election has been made under section 2032A and the signed agreement has been accepted. The Form 668H is filed in the name of the estate and all qualified heirs with an interest in the QFOBI as reflected in the election and recapture agreement.

The federal tax lien filed under section 2057(i)(3)(P) should have the same effect and be accorded the same priority as liens recorded under section 6324A. That priority provision of section 6324A is incorporated by reference in section 6324B which is incorporated in 2057. There is no reason whatsoever why the 2057(i)(3)(P) federal tax lien would have to meet the recording requirements of any provision other than the Internal Revenue Code as specified in 6324A(d)(1) and 6324B(c)(1) in order to be perfected for all purposes. However, that may not be the case if the heirs offer "other security" to substitute for the special lien under Internal Revenue Code § 6324A(d). In the case where the Service accepts other security in lieu of the lien under Internal Revenue Code § 2057(i)(3)(P), you should consult with Counsel to make sure, in the individual case, that the Service has perfected its interest. In the case of substitute security,

the Service may need to consider whether the interest of the Service is perfected under state law. But in the case of the filed 2057(i)(93)(P) lien, perfection under 6323(f) is all that is required.

Preparing and recording the lien under section 6324B in the case of 2032A elections is easy because the lien specifies and is recorded against real property. In the case of the 2057 election, it seems that there are a number of issues which complicate the preparing and filing of the lien. If the lien is recorded against the qualified business interest in a corporate business, the property specified should be the stock held by the heirs' corporation. That is a personal property interest, so under section 6323(f) and the state statute designating the place for the recording of federal tax liens, the particular Form 668H should be recorded wherever liens against the personal property are recorded.

Similarly if you are perfecting an interest against the heirs partners in a partnership which qualifies as a QFOBI, you are perfecting the lien against the partnership interest which is personal property under state law. The lien would be recorded against the partners/heirs. Section 2057 refers to the "interest" which will be subject to the lien for the recapture tax as the interest in the entity so that the lien would specify the interest of the partners who are the qualified heirs and not the partnership itself.

Since, generally, 6324B liens have been recorded against a parcel of qualified real property, the situs of the recording was obviously the county in which the property was located. However, where you are perfecting a 2057(i)(3)(P) lien, it appears that, in order to perfect the lien against the heir's interest in the QFOBI, a personal property interest, you need to record the lien in each state where the qualified heir named in the lien resides.

An even more perplexing scenario arises where the QFOBI is the heir's interest in a proprietorship. Section 2057 contemplates a qualified business interest in a "proprietorship." Internal Revenue Code § 2057(e)(1)(A). A "proprietor" is one who has legal or exclusive title to anything--an owner. Black's Law Dictionary. The proprietorship is an exclusive right to unlimited or limited profitable use of an ascertainable subject compounded of the proprietor's beneficial rights and his right of excluding other persons from the use or profit. 73 C.J.S. p. 220. In other words, proprietorship is ownership.

So if the lien is recorded against the heir's interest in a proprietorship, the lien must ostensibly be perfected against

them as owners of the assets which comprises the business. The lien must identify the estate and heirs and, ostensibly, the asset under which the proprietorship operates. However, if the business owns real property, the lien must legally describe the real property interest to which the lien attaches and the lien must be recorded in the county where the real property is located. The lien would also have to be recorded in the office designated for perfecting liens against owners of personal property in each state where an heir resides since the heir has a qualified interest in the assets as opposed to the stock or a partnership interest.

An additional dilemma which you may never face is determining how to record the 2057(i)(3)(P)lien where an heir is a noncitizen. The noncitizen-qualified heir must hold his interest in a qualified trust. Internal Revenue Code § 2057(g)(1). So if you want to perfect the lien against his interest, the lien will have to be recorded against the trustee of the trust. If that situation arises, please consult with Counsel.

We anticipate that the next question will be how to perfect the lien against the interest in an LLC. Whether the LLC is single or multiple member LLC in the states in this area, it is recognized as a separate entity under state law.² In Washington, and probably in other states in this area, the interest in an LLC is personal property. RCW 25.215.245. A "member" has no interest in specific property RCW 25.15.245. The lien should be perfected against the member/heir in the same manner as the lien against a partner's interest in the partnership.

² Whether an entity is regarded as having limited liability under state law for collection purposes is different from the question as to how the entity is taxed under federal law.

CONCLUSION

The Special Lien for Additional Estate Tax Attributable to Farm or Business Property Valuation under 2057(i)(3)(P) should be recorded against the qualified family-owned business interest in the same manner as liens are recorded against personal property under Internal Revenue Code § 6323(f). You must carefully determine the character of the interest held by the heirs in the family-owned business so that it can be accurately described on the tax lien. We recommend that, if you have any question about the nature of the interest or how to describe it on the lien, you consult with Counsel.

We have been advised by the National Office that guidance has been issued on the Section 2057(i)(3)(P) liens. The Form 668H will be revised to include instructions for filing the lien in 2057 cases. We have reviewed the advice recently issued in the [REDACTED] matter in Denver. In that advice the National Office recommends that the 2057(i)(3)(P) lien be secured first by real property. That is preferable; however, in most instances, as a practical matter, the QFOBI qualifying for the deduction will usually be personal property.

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